

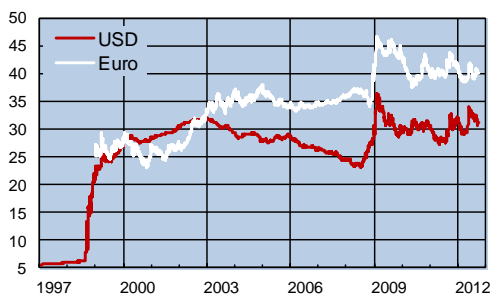
Russia

CBR looks to phase out ruble exchange-rate steering in 2015. The Central Bank of Russia's first deputy chairman, Alexei Ulyukayev, has confirmed the central bank's plan to shift the basis of monetary policy over the next three years to inflation targeting and abandoning the current ruble's exchange-rate targeting. Simultaneously the CBR will abandon the fluctuation band, within which it keeps the rouble's exchange rate by interventions. The CBR has used this "managed float" policy for the ruble since 1999, before which the ruble was pegged to the US dollar. The managed float system has been made more flexible over the years and the fluctuation band has been gradually widened.

Over the entire period, the CBR has strived to achieve the sometimes counterproductive goals of fighting inflation and steering the ruble's exchange rate. This has been particularly challenging during periods of high global oil prices when massive inflows of export earnings have put appreciation pressure on the ruble. This, in turn, has forced the CBR to buy up foreign currency on the forex market, thereby increasing the stock of rubles in circulation and stoking inflationary pressure.

For several years already the official stated goal of the CBR has been to abandon exchange-rate targeting to allow the bank to focus on fighting inflation through interest rate policy. Since the 2008–2009 financial crisis, the CBR has begun to emphasise inflation goal and clearly reduced interventions in the forex markets (which can be seen in wider fluctuations in the ruble exchange rate).

Dollar-ruble and euro-ruble rates, 1997–2012



Source: Central Bank of Russia

Russia sees record-high grain prices; possible import restrictions a hot topic for the government. The exceptionally dry summer has meant that this year's grain harvest will come in at just over 70 million metric tons, or 10 % below the average harvest size of the past decade and nearly 25 % below the 2011 harvest. This year's grain harvest includes about 40 million tons of wheat.

Wheat prices increased rapidly at the end of September, when the large export firms purchased wheat to fulfil existing export contracts. Observers expect the government to

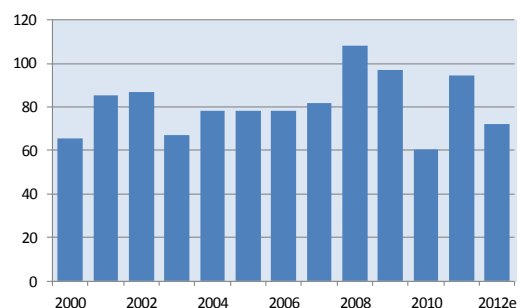
decide soon on whether to begin grain sales from state reserves to prevent a sharp rise in domestic grain prices.

Russia's poor harvest has raised discussion on international grain markets as to how the situation will affect Russian grain exports. Thanks to a series of good harvests in the latter half of the 2000s, Russia became a globally significant grain exporter, wheat in particular. Russia currently is the world's third largest wheat exporter. However, after the 2010 crop failures, the government banned all grain exports for almost a year until new supply was produced. The lack of Russian grain was felt on the international markets.

The economy ministry says grain exports need to be limited to keep domestic prices from rising too sharply. First deputy prime minister with portfolio for agriculture, Arkadi Dvorkovich, however, vigorously opposes any attempts to restrict exports.

Russia's own grain consumption remained stable at around 70 million tons throughout the 2000s. Due to good harvests in recent years, Russia's grain reserves are currently about 20 million tons – enough for Russia meet its own needs and still export an estimated 10–14 million tons this year. Last year, Russia exported a record 27 million tons of various grains.

Russian grain harvests, 2000–2012 (million tons)



Source: Rosstat

Government decides on allocation of Sberbank sale proceeds. On Monday (Oct. 1), the Russian government decided that the revenue from last month's sale of Sberbank shares on the London and Moscow stock exchanges will be transferred directly to the federal budget. According to the government, the CBR is only a formal owner of Sberbank, and acted as an agent of the Federation in the share offering, while the true owner is the Russian Federation. To get the money immediately, the government is formulating a special law. Otherwise, the money would be passed on to the federal budget later on, together with the 75 % of CBR profits that are annually transferred to the federal budget.

One alternative, supported by Moscow city, would have made the CBR pay a 20 % profit tax on earnings from the share sale. The main part of the tax would have gone to the City budget. The government nixed this proposal.

China

Important Communist Party meeting scheduled for November.

The Communist Party's National Congress will convene on November 8 and run for about a week. The starting date of the National Congress was kept secret until the end of September. The National Congress assembles every five years to decide about major policy directions and choose the party central leadership. This time around, seven of the Politburo Standing Committee's nine members have reached retirement age, including General Secretary Hu Jintao. The person chosen as the new General Secretary will also be nominated as the new President of China at the 2013 People's Congress next spring. Another member of the Standing Committee will be tapped as premier. The two members of Standing Committee that have yet to reach retirement age are Xi Jinping, the favourite to be China's next General Secretary and president, and Li Keqiang, who is likely to be China's next premier.

Despite recent yuan appreciation, exchange rate changes against the dollar have been quite small.

The yuan's exchange rate against the US dollar this year stayed stable up to May, before weakening by over one percent to about 6.39 yuan to the dollar in response to the worsening of the European debt crisis, China's slowing economic growth and rising flow of capital leaving the country. Nevertheless, without a change for better in China's economy, the yuan's exchange rate has been rising against the dollar since July. Last Friday, just ahead of this week's National Day Holiday period, the yuan-dollar rate stood at 6.28 – stronger against the dollar than it has ever been.

Even so, the shifts in the yuan's exchange rate relative to the dollar have been modest and have occurred under the strict direction of the People's Bank of China. There is no obvious single explanation for the yuan's recent appreciation. Yields on paper issued by the state and the central bank have generally been rising, while rates on interbank markets have shown less consistent trends. Part of the reason for the yuan's recent strengthening comes from abroad. The recent decisions of the US and Japanese central banks to increase their money supplies (e.g. QE3) may have boosted investment flows to China and thereby strengthened demand for yuan.

The reduction in imbalances in trade and capital movements in recent years has relieved a substantial part of appreciation pressures on the yuan. In the first six months of this year, China's current account surplus was \$77 billion, about \$10 billion less than for 1H2011. Due to growth in capital exports the financial account surplus declined to meagre \$15 billion, down from \$184 billion in 1H2011.

Growth of China's foreign currency reserves has slowed substantially and in the second quarter of this year the reserves actually contracted.

Although the yuan's exchange rate strengthened in the yuan futures markets in September, the current offer in Hong Kong (Non-Deliverable Forward, 5.10.) suggests the yuan will weaken to a level of 6.40 to the dollar over the next twelve months. Since last year's appreciation episode, the yuan's real effective exchange rate has hardly changed. In long term, much faster economic growth in China than in other countries creates pressure for yuan to appreciate further.

Mainland and offshore yuan-dollar exchange rates (decline indicates yuan's appreciation)



Source: Bloomberg

China's global competitiveness declines. The latest World Economic Forum [Global Competitiveness Report 2012–2013](#) ranks China 29th out of the 144 countries surveyed this time around. China's ranking dropped from 26th place last year. This year's WEF report, which is based on 2011 data, finds the world's most competitive countries are Switzerland, Singapore and Finland. The World Economic Forum looks at competitiveness from many perspectives, taking into account various sectors of the economy and social institutions.

The decline in China's competitiveness has been across-the-board; over half of the 110 indicators showed declines in values from the previous survey. While no big individual changes were detected, the indicators showing the most deterioration were costs caused by criminality, barriers to foreign trade and agricultural policy costs. In addition, regulatory changes complicated foreign firms' operations in China. Most of the handful of indicators showing improvement related to improvements in health. Moreover, a larger share of Chinese now attends school, but the quality of education has fallen.

Although China's competitiveness weakened, it is still much better than the other BRICs. Brazil currently ranks 48th (53 last year), India 59th (56) and Russia 67th (66).